THE BALANCE OF PAYMENTS OF THE UNITED STATES; A MEASURE OF THE NATION'S ECONOMIC WELL BEING

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Submitted in partial fulfillment of
the requirements for the degree of

MASTER OF SCIENCE
IN
MANAGEMENT

United States Naval Postgraduate School
Monterey, California

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ABSTRACT

Since 1958 the United States has been experiencing a significant increase in the deficits of its international balance of payments. These deficits have been financed, to a sizeable degree, by substantial losses in the gold reserves of this country. This condition reflects a weakening of the dollar in the eyes of the world. This paper discusses the causes of these payments deficits and traces the history of the dollar since World War II. Alternate solutions to remedy the payments problem are evaluated and conclusions and recommendations are made which will remedy the current payments problem and restore the U. S. dollar to its former status in the world.

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CHAPTER I

INTRODUCTION

Since 1958 the United States has been experiencing a significant change in its position as the world's foremost source of monetary assets and possessor of the most stable of international currency systems. A decade ago the United States dollar was regarded as a superstrong currency and was considered on a par with gold as an international medium of exchange. During the last several years, however, this country has been encountering a condition which has caused a dampening of the economic well being of the nation as a whole and has resulted, among other things, in a weakening of the dollar in the eyes of the world. This condition is a substantial and continuing deficit in this country's international balance of payments. The excess of international payments over receipts, in turn, has been financed, to a significant degree, by a substantial outflow of United States gold reserves. Figure 1 depicts the scope of the balance of payments deficit and its resulting gold flow since World War II.

A nation which is experiencing continuing deficits in its international transactions may be compared to a company whose financial balance sheets and operating statements show continued net losses; something must be done to correct the situation before the financial resources, in this case gold, are exhausted. The situation is much more complex, however, in monetary transactions between nations because of the many and varied forces acting on the payments balance. How one nation acts on the world market has an effect upon all other nations; the nation's external exchange is not independent of its internal well being; political, economic, military as well as financial considerations influence trade relations between nations. In a word, a nation's ability to balance its international payments depends not only on those elements over which it can exercise control, but also on external forces over which it has no control.

In the case of the United States, the situation which has developed

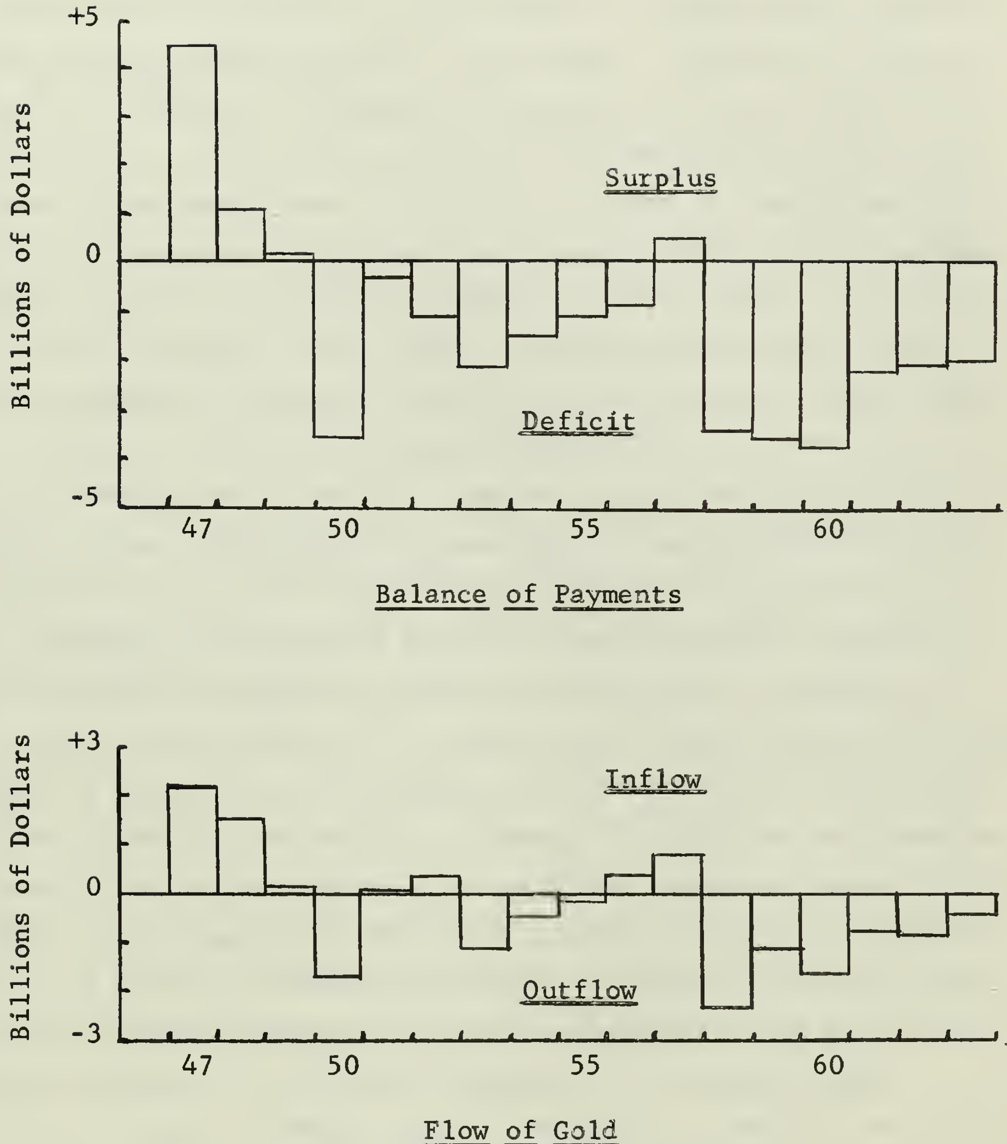

FIGURE 1

UNITED STATES' BALANCE OF
PAYMENTS AND FLOW
OF GOLD (1947 - 1963)

in the last six years has been a cause for great concern not only because it has significantly depleted our gold reserves, but more importantly, because it is symtomatic of an unhealthy inbalance in the price-cost relationships existing in this country as compared with those of the other industrialized nations of the world. Despite all efforts thus far, this country's international payments balance problem has defied solution. It has been estimated that the policies which the United States has been forced to follow to combat the deficits have resulted in a dampening of the national output, with present manpower and other resources, by some $30 billion to $40 billion.

It is the purpose of this paper to analyze and evaluate the balance of payments situation in which the United States finds itself in 1964. By way of background, Chapter II defines the concept of balance of payments and identifies the various accounts which make up the balance. The criteria which constitute a disequilibrium in the payments balance are evaluated and the causes of these criteria are defined. Chapter III builds on Chapter II and describes conditions which are causing the present deficit in the balance of payments of the U. S. and cites statistics to indicate the scope of these deficits. An attempt is made to relate apparently isolated factors to quantify further the causes of the deficit. Chapter IV describes the remedies which have or are being taken to eliminate the payments disequilibrium and restore the integrity of the dollar. Included therein is also a discussion of possible adverse effects of a favorable balance of payments in the United States and the danger of insufficient world wide liquidity to permit full natural development of foreign trade.

Finally, Chapter V makes certain conclusions regarding the present payments deficit and makes recommendations for permanently solving the balance of payments problem.

CHAPTER II

THE CONCEPT OF BALANCE OF PAYMENTS

Balance of Payments: Definition

The measure of a nation's payments to and receipts from foreign individuals, governments or institutions is revealed in the nation's international balance of payments. As the terminology would suggest, this is a measure of the relationship between the flow of funds into and out of a particular country during a particular period of time. The United States Department of Commerce has defined this concept as follows:[1]

> The balance of payments of a country consists of the payments made, within a stated period of time, between the residents of that country and the residents of foreign countries. It may be defined in a statistical sense as an itemized account of transactions involving receipts from foreigners on the one hand and payments to foreigners on the other.

In a word, it is a summary of the money value of all exchanges and transfers of goods, services, and evidences of debt or ownership between the residents, businesses, governments, and other institutions of one country and the rest of the world during a given period of time.

The balance of payments is a balance sheet showing debits and credits and as such, the two must always be equal. Any imbalance must be offset by a flow of gold or suitable credit arrangements between the countries involved. Since the need to keep the international flow of funds in balance among all nations is the key to the solution of the problem of excessive gold reserve losses which exists in the United States, a detailed analysis of the nature of the balance of payments follows.

[1]United States Department of Commerce, The Balance of Payments of the United States (Washington, D. C.: 1937), p. 1.

All of one nation's transactions with other nations may be divided into debits and credits. The debits give rise to claims for payment against a resident, business, or government of the country by someone outside the country and the credits result in claims for payments by domestic residents or institutions against foreign interests.

Balance of Payments: Structure

The balance of payments is more than a mere statistical statement of a country's international transactions; it can also be used as an analytical tool to reveal significant data and trends in the international stature of a nation and also to isolate potential problem areas. However, in order to make intelligent use of the data, it is necessary to catagorize them into a functional or "horizontal" classification in addition to the "vertical" debit and credit classification previously described.[1]

Consequently, the information furnished is usually divided into four types of transactions:[2]

1 - Current account transactions (flow of goods and services).

2 - Capital account transactions (evidences of debt or ownership).

3 - Unilateral transfer account transactions.

4 - Gold account transactions.

The credit side of the current account represents the international income of the country resulting from the export of goods and services. The debit side discloses the value of the imports of goods and services. The services referred to include transportation, travel (tourists), interest and dividends on international investments, banking and insurance services, and government expenditures.[3] If a nation's exports of goods and services during a period exceeds its imports of these

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[1] Delbert A. Snider, Introduction to International Economics (Homewood, Illinois: Richard D. Irwin, Inc., 1963), pp. 140, 141

[2] Ibid., p. 141.

[3] Ibid., p. 143.

commodities, the difference will be shown as a credit on the balance of payments and is referred to a favorable balance of trade.[1] The capital account which embraces all international transactions of stocks, bonds, other securities, national currencies and bank deposits is usually divided into short term (falling due in one year or less) and long term. Decreases of United States bank and brokerage balances abroad and increases of foreign held bank and brokerage balances in the United States are credits as is the sale of long term capital claims to foreign interests since they all result in payments being made to the United States; the reverse are debits.[2] Unilateral transfers are, as the name implies, remittances, grants in aid and gifts for which no payment is made or expected; those received are credits and those given are debits. Finally, the gold account will be considered. The gold referred to here is monetary gold rather than commodity gold which is treated in the current account. Since it is universally accepted as a means of payment, it has special significance as a monetary asset. An export of gold is a credit and an import is a debit entry. The rule is the same as for merchandise and the opposite of that for capital, that is, capital exports are debits.[3]

Table I shows the United States Balance of Payments for the year 1961.

The balance of payments must, be definition, balance; any imbalances in the current, capital, and unilateral accounts, taken together, must be compensated for by a change in monetary reserve assets which are represented by movements of gold or changes in the "tranche" position of the United States in the International Monetary Fund.[4] However, a

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[1] Charles P. Kindleberger, International Economics (Homewood, Illinois: Richard D. Irwin, Inc., 1958), p. 23.

[2] Snider, op. cit., p. 143.

[3] Kindleberger, op. cit., p. 31.

[4] Walter S. Salant and others, The United States Balance of Payments in 1968 (Washington, D.C.: The Brookings Institution, 1963), p. 10. The "gold tranche" position is described as the amount a member may draw essentially automatically under the International Monetary Fund's gold tranche policy.

The Balance of Payments of the United States, 1961

(Millions of Dollars)

	Debit	Credit
I Current Account		
Merchandise Trade (excluding military transfers)	$14,514	$19,915
Military transfers under grants (net)		1,465
Income from Investments	882	3,682
Transportation Services	1,991	1,685
Travel	1,747	975
Other Services	3,789	1,809
Total Goods and Services	$22,923	$29,531
Balance		$ 6,608
II Capital Account		
Long Term:		
Movement of U. S. Capital	$ 4,542	$ 1,397
Movement of Foreign Capital		606
Total Long Term Capital	$ 4,542	$ 2,003
Balance	$ 2,539	
Short Term:		
Movement of U. S. Capital	1,734	$
Movement of Foreign Capital		1,719
Total Short Term Capital	$ 1,734	1,719
Balance	15	
Total Long & Short Term Capital	6,276	3,722
Balance on Total Capital	$ 2,554	
III Unilateral Transfer Account		
Private remittances (net)	$ 643	
Gov't grants and other transfers (net)	$ 3,551	
Total	$ 4,194	
Balance	$ 4,194	
IV Gold Account		
Movements of Gold (net)		$ 742
Balance		$ 742
Total of all accounts	$33,393	$33,995
Errors and Omissions	602	
Corrected total of all accounts	$33,995	$33,995

Source: U. S. Department of Commerce, Survey of Current Business, June, 1962, p. 16

TABLE I

measurement of the flow of gold into or out of a country or changes in its International Monetary Fund position do not tell the full story of international imbalances of payments. Foreign banks, individuals, and governments usually retain a large amount of United States dollars in the form of bank accounts rather than converting them entirely into gold. This is revealed by referring to the short term component of the capital account. A credit entry in this caption would indicate an increase in bank deposits and short term investments during the period; these assets are readily convertible into gold at the owner's option. The algebraic sum of these short term assets and the movement of gold would give the complete picture of a country's international payments stature.[1]

Table II shows the differences between the United States international receipts and expenditures since 1947 and how this difference was financed. The increases of dollar liabilities to foreigners represents that portion of the payments imbalance financed by short term capital movements rather than by gold. Maintaining confidence in the soundness of the dollar is an important consideration in encouraging foreign investors to keep their holdings in these short term notes rather than converting them to gold. These short term notes greatly increase the international liquidity of the nation issuing them.

Thus, it is evident that a government such as the United States, where gold represents a significant portion of its monetary reserves, must maintain ample quantities of these reserves. Any continued outflow of gold coupled with increases in short term liabilities to foreigners which are convertible to gold at a moments notice, undermines the stability of the monetary standard. The ultimate of such a condition is drastic changes in monetary policies with the resulting international repercussions.

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[1]Snider, op. cit., p. 149.

Total Net Balance of Payments of U. S. & How It Was Financed

	Total Surplus or Deficit(-)	Increase (+) or decrease in Monetary Reserves			Increase of liquid $ lia to foreigners
		Gold	I.M.F.	Convert. Currencies	
1947	4,567	-2,162	-1153		-1,252
1948	1,005	-1,530	- 206		731
1949	175	- 164	- 102		91
1950	-3,580	1,743	15		1,822
1951	- 305	- 53	20		338
1952	-1,046	- 379	- 36		1,461
1953	-2,152	1,161	95		896
1954	-1,550	298	182		1,070
1955	-1,145	41	141		963
1956	- 935	- 306	- 563		1,804
1957	520	- 798	- 367		645
1958	-3,529	2275	17		1,237
1959	-3,743	1,075	- 40		2,708
1960	-3,881	1,702	741		1,438
1961	-2,370	857	- 135	-116	1,764
1962	-2,186	890	626	17	653
1963	-2,165	461	30	-113	1,787

Source: U. S. Department of Commerce, Survey of Current Business, various issues.

TABLE II

Disequilibrium in the Balance of Payments

Now that the concept of balance of payments has been established, it is necessary to explore the relationships which exist among the various accounts and what constitutes equilibrium (or disequilibrium) in the balance of payments.

Since the total of the credits and debits of the overall payments balance must always be equal, significant information can only be revealed by an evaluation of the relationships among the various accounts. It is theoretically possible for each account to be in balance, thus placing the entire balance of payments in a state of static equilibrium; however, quite obviously, this is a highly improbable condition.[1] Normally, positive balances in some accounts are offset by negative balances in other accounts. A critical relationship is the one which exists between the current account on one hand compared with the other accounts.[2] When the current account shows an excess of debits, the potentiality of deficit is greatest; however, an imbalance in the current account is not, in itself, evidence of overall disequilibrium. An example will serve to illustrate this. Long term investments on foreign markets are considered a necessary and desirable part of international trade since they are the result of differing national relative scarcities.[3] High foreign interest rates attract investment of capital. This type of transaction results in a debit in the long term capital account which may be balanced by a credit in the current account. Likewise, if a nation receives unilateral transfers or gifts, reflected by a credit in the unilateral transfer account, equilibrium in the balance of payments can only be maintained by offsetting debits in the current and/or long term capital account. So

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[1]Kindleberger, op. cit., pp. 470, 473.

[2]Snider, op. cit., p. 165.

[3]Ibid.

long as the current account, long term capital account and unilateral transfer account, all taken together, are in balance, the overall balance of payments is in equilibrium. However, when there is a net imbalance in the above three accounts which must be offset by an opposite imbalance in the short term capital or gold account, the overall balance of payments is said to be in a state of disequilibrium. In this situation, the debtor nation must finance the deficit by an outflow of gold or by short term capital movements; a creditor nation will receive gold and will grant short term loans to her debtors.

A point is made that while a creditor nation may feel secure with the increase in her monetary reserves, such a view is shortsighted and suboptimizes the broad picture. A creditor nation implies the existance of debtor nations. Since each nation is in some way dependent on all other nations in the long run, only long run equilibrium of balance of payments for all nations should be the ultimate goal of each country.[1]

The above discussion of the criteria which constitutes an imbalance in the balance of payments of a nation does not indicate what causes these imbalances. Various authors identify these causes in different ways; however, the following list is considered representative of the generally accepted reasons for the existence of a state of disequilibrium:[2,3,4]

1- Gradual changes in foreign demand for a nation's products due to changes in tastes or changes in relative ownership of productive factors and specialization will have a long run effect on the current account.

2- Destruction of a nation's exportable goods. This is particularly applicable to countries whose main export is raw materials or agricultural products.

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[1]Address by Under Secretary of the Treasury Robert V. Roosa at an American Economic Association luncheon, Boston, Massachusetts, December 28, 1963.

[2]Rollin G. Thomas, Our Modern Banking and Monetary System (Englewood Cliffs: Prentice-Hall, Inc., 1957), p. 518.

[3]Snider, *op. cit.*, pp. 203-219

[4]Kindleberger, *op. cit.*, pp. 487-543.

3- Changes in the direction and volume of long term capital investments or borrowings, especially if they occur over a short period of time.

4- War and its disruption of normal international trade, destruction of capital goods and obsolescence of capital goods.

5- Political decisions effecting relations between nations such as the lack of normal trade relations between the Soviet bloc nations and the West or the special trade agreements between members of the Common Market.

6- Monetary exchange rates, changed through government action, can cause disequilibrium by causing internal inflation or exports of capital.

7- Inflation or deflation within a nation and the level and distribution of income within the nation will effect that nation's ability or desire to conduct international transactions.

8- Abrupt and heavy movements of short term capital from currencies suspected of weakness, such as occurs when a currency is devalued.

The first five of the above cause are usually referred to as structural, or those resulting from maladjustments in the basic structure of an economy in relation to the world economy.[1] The last three causes are identified as cyclical or monetary and are of a shorter run character originating in short term fluctuations in money income and price relationships.[2]

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[1] Snider, _op_. _cit_., p. 203

[2] _Ibid_. p. 212.

CHAPTER III

THE BALANCE OF PAYMENTS PROBLEM IN THE UNITED STATES

Using the framework developed in the previous chapter as a base, the balance of payments and loss of gold difficulties which the United States is experiencing can now be identified and evaluated. Table III cites the significant statistics of the United States' Balance of Payments since 1947. It may be seen from these figures that the situation in this country is unique since the United States is encountering significant payments deficits despite the existance of substantial current account surpluses.

This chapter traces the changes which have taken place in the United States balance of payments status since 1945 and cites the probable reasons for these changes. The forces acting to cause the present payments problem will be reviewed and their significance analysed.

It will be left to Chapter IV to suggest ways of correcting the present situation before it permanently damages the monetary position of the United States.

History of the Balance of Payments in the United States: 1945-1963

World War II left all of the industrial nations of the world, with the notable exception of the United States, in a state of almost complete economic collapse. Even the factories in England had become obsolete or worn out and were poorly prepared to enter upon an era of reconstruction. The financial positions of these nations were either non existant, as in the case of the defeated powers, or were in such a state of exhaustion that they were not capable of providing the funds necessary to spark the nations' economy into peacetime motion. These nations, on the other hand, emerged from the war with demands on their resources far in excess of their capacity to supply. Consumer wants

U. S. Balance of Payments

	Goods and Services (Net)	Private Remittances (Net)	Private Long Range Capital Total	Gov't Capital & Unilateral Transfers (Net)	Misc Total	Total Balance Surplus (+) Deficit (-)
	Current Acct					
1947	11,529	-669	- 896	-6,167	770	4,567
1948	6,440	-683	- 962	-4,852	1,062	1,005
1949	6,149	-521	- 621	-5,758	926	175
1950	1,779	-444	-1,048	-3,719	- 148	-3,580
1951	3,671	-386	- 740	-3,262	412	- 305
1952	2,226	-417	- 900	-2,508	553	-1,046
1953	386	-476	- 322	-2,196	456	-2,152
1954	1,828	-486	- 713	-1,683	- 496	-1,550
1955	2,009	-444	- 674	-2,352	316	-1,145
1956	3,967	-530	-1,961	-2,497	86	- 935
1957	5,729	-543	-2,902	-2,733	969	520
1958	2,206	-540	-2,552	-2,769	126	-3,529
1959	134	-575	-1,589	-2,637	924	-3,743
1960	3,769	-458	-2,114	-3,031	-2,047	-3,881
1961	5,444	-470	-2,143	-3,685	-1,516	-2,370
1962	4,826	-491	-2,495	-3,909	- 117	-2,186
1963	5,485	-143	-3,053	-4,147	- 307	-2,165

TABLE III

Excludes goods and services transferred under military grants
Source: U. S. Department of Commerce, Survey of Current Business, various issues.

plus the need for restoring and expanding productive capacity created a heavy demand for imports while at the same time reducing the ability of these nations to export any goods or services. Thus, the European nations and Japan did not have any available resources to pay for their needed imports of capital goods.

The condition which existed at the close of 1945 is usually described as a period of a dollar shortage. The United States had the ability to supply the needed goods and foreign nations had great need of these goods. However, the means of paying for the goods did not exist since the gold and dollar assets of these nations had been exhausted by the war liquidations of oversea investments. Since these nations did not then have the productive capability to balance the amount of their needed imports with a similar value of exported goods, and no sources were available from which they could borrow the large sums of money required, they had no way of independently generating international liquidity. To rebuild their economics practically from scratch without any outside help gave prospects of a painfully slow recovery.

It is evident that a continuing dollar shortage results in an abnormal inflow of gold into the United States and has a detrimental effect on the overall world liquidity since the international monetary reserves of foreign nations are gradually absorbed by the United States without replacement. A dollar surplus, on the other hand, results in an outflow of gold from this country with its disturbing effect. Thus in the long run, only equilibrium in the balance of payments total for all nations will result in a healthy world wide state of economic well being.

Prompted by the need to restore prewar standards of living and a free multilateral world trading system, the United States adopted a variety of aid programs during the period 1946-1949. The most famous of these was the European Recovery Plan, the so called Marshall Plan. During this period the United States balance of trade showed a surplus (excess of exports) of $31.9 billion[1] of which approximately $25 billion

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[1]United States Department of Commerce, Survey of Current Business, various issues (Washington, D. C.: Government Printing Office.) See also Appendix C.

was financed by the United States Government. Half of this amount was in the form of outright grants. With this aid as a "pump primer", the Europe of 1946 was transformed, within a remarkably short period of time, into a dynamic economy of unprecedented prosperity and growth.

During this period the United States experienced substantial international payment surpluses and, by 1949, had accumulated about 70% of the free world's gold supply. This is pictorially represented in Figure 2.

The period 1950-1957 was one of more or less equilibrium for the balance of payments of the United States although the net accumulation of gold and dollar reserves by foreign countries during this period was over $10 billion, that is the United States had a deficit balance of payments of this amount. However, this was considered as a planned deficit and was not viewed with alarm by an fiscal official.[1] Although United States exports more than doubled during this period, its imports quadrupled and the United States Government grants and loans more than offset the export surplus. (See Figure 3).

The period from 1958 to the present has variously been described as a period of dollar "glut" or an excess of international dollar expenditures by the United States.[2] It was characterized by a significant outflow of gold and the creation of short term foreign liabilities. During this period the United States moved from a position of having ample gold supplies to cover all outstanding liabilities to a position of having less gold than would be needed to cover potential foreign claims against it for payment in gold.

Referring again to Figure 2, the significant increase in the payments deficit since 1958 and the depleting of the gold supply of the United States since then is indicated.

Causes of the Balance of Payments Deficit in the United States

The change from a dollar shortage to a dollar surplus was accompanied by several significant changes in the balance of payments picture.

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[1]Salant, op. cit., p. 11.

[2]Snider, op. cit., p. 223.

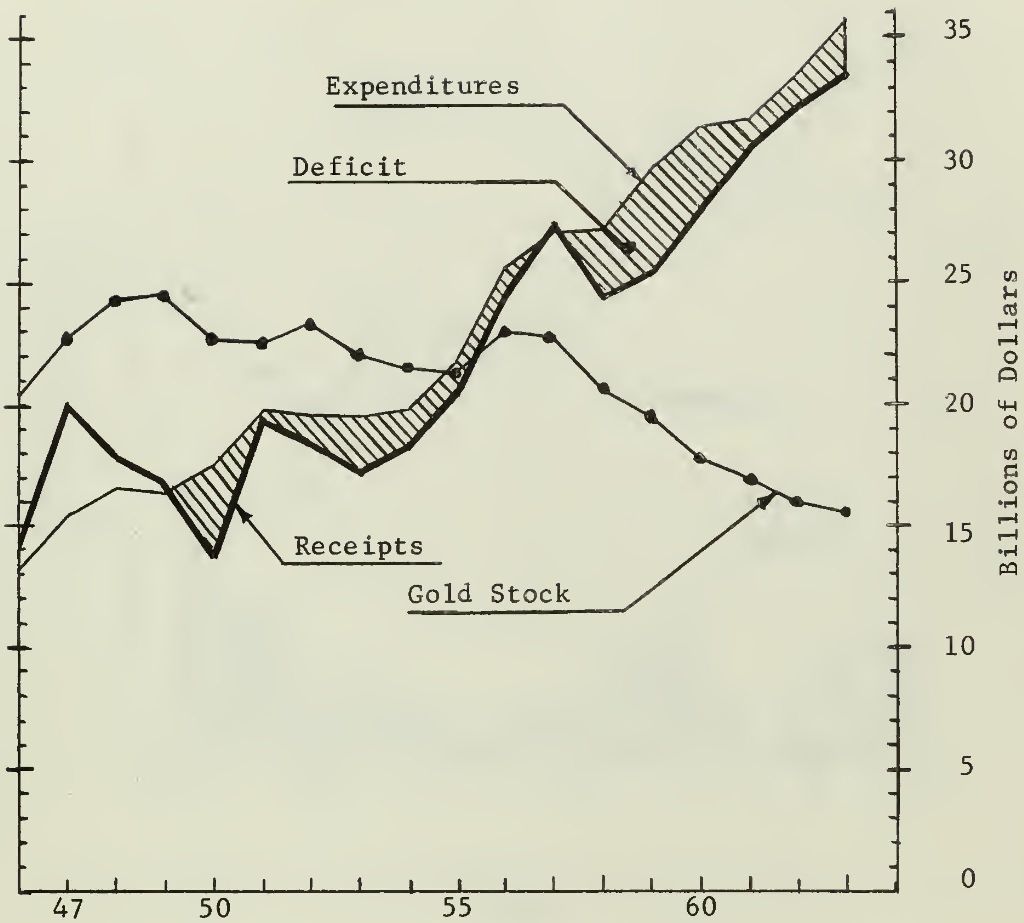

FIGURE 2

UNITED STATES' GOLD STOCK
AND BALANCE OF PAYMENTS
RECEIPTS AND EXPENDITURES

(1946-1963)

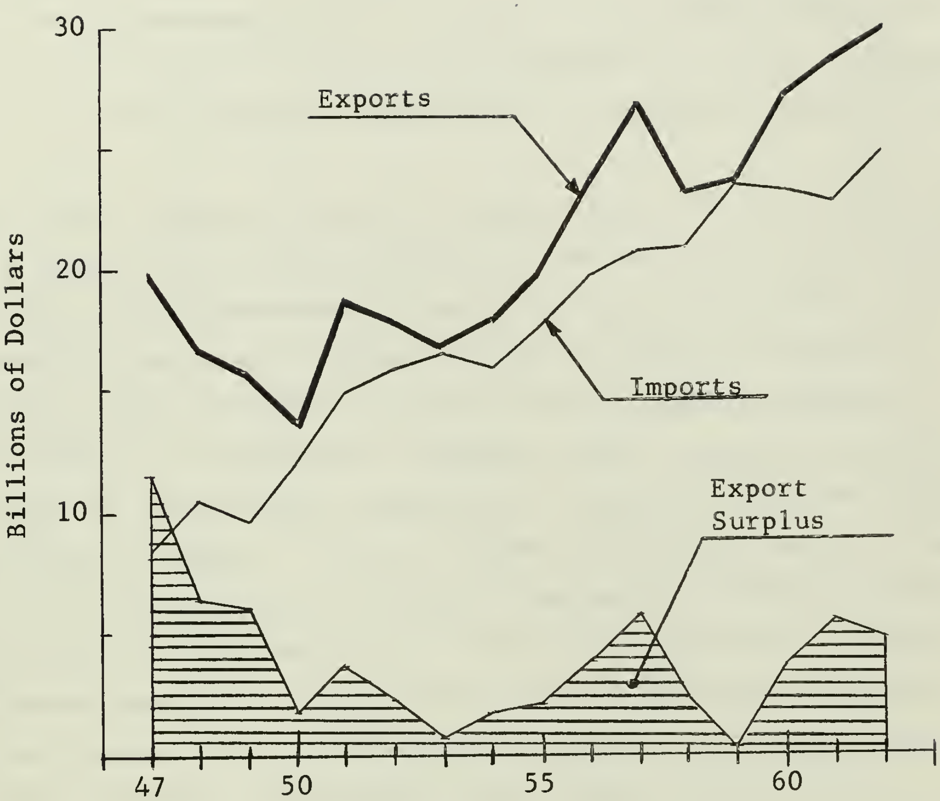

FIGURE 3

BALANCE OF TRADE OF
THE UNITED STATES
(1947-1962)

The success of the Marshall Plan aid was so great that the nations which received the aid recovered to the point that they began competing with the United States for markets for their export goods. The effect of this competition was evidenced by the decrease in the United States portion of the world export trade marked from 33% in 1950 to 20% in 1962.[1] Since World War II, the export surplus of this country has decreased from approximately $8.0 billion per year during 1946-1949 to an average of $3.8 billion per year during 1958-1961. Figure 3 graphically represents the dollar value of United States exports and imports since 1946.

From these figures it has been hypothesized that the United States is pricing itself out of the world market, causing its current account balance to be further worsened. However, this decline in price competitiveness did not result primarily from any general increase in United States prices relative to those in other leading industrial countries; rather, it reflected a relative rise in prices of certain products that are particularly important in foreign trade, and especially in this country's exports.[2] Table IV shows the general wholesale price indices of the United States and other countries for 1959 (with 1953=100) as compared with the wholesale price indices of machinery, vehicles, metal and metal products. These figures reveal significantly greater relative increases in the prices of these commodities in the United States than the rise in the general price index in this country. An exhaustive study conducted by the United States Department of Commerce covering the period 1954-1961[3] has revealed that the losses in products markets by the United States during this period were concentrated in

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[1]"The Balance of Payments Bind", Fortune LXVII-6 (June, 1963) p.112.

[2]Salant, op. cit. p. 70.

[3]U. S. Department of Commerce, International Economic Analysis Division, Comparative Statistics on Exports of Manufacturers from the United States, Western Europe and Japan, 1954-1960.

Wholesale Price Index - 1959

1953 = 100

	General	Machinery and Vehicles	Metal and Metal Products	
			Total	Iron and Steel
	Col 1	Col 2	Col 3	Col 4
United States	108	124	121	131
Belgium	101	102	104	108
France (adjusted by devaluation)	92	n.a.	93	94
West Germany	102	106	108	n.a.
Italy	98	95	91	90
Netherlands	106	105	105	n.a.
Sweden	107	103	106	106

Source: Col. 1- Organization for Economic Cooperation and Development, General Statistics (March, 1963)

Col. 2, 3, 4- Organization for European Economic Co-operation, The Problem of Rising Prices (Paris, 1961), Appendix 1.

TABLE IV

these same three commodity groups: road motor vehicles, iron and steel, and industrial machinery (other than power generating and metal working).[1] Thus, it can be concluded that the loss in export markets of the United States was due to significant relative rises in prices of certain commodities which are particularly important in this country's foreign trade. The Department of Commerce study fails to reveal any general decline in the United States competitiveness as indicated by shares of individual area product markets for manufactured exports.[2]

In addition, although wage rates in foreign countries are considerably lower than those in this country, what is equally important, the rate of productivity in the United States is significantly higher than in foreign countries. In fact, the cost per unit of output, especially in agriculture, is as low or even lower here than in other countries. In addition, since 1958 costs per unit of output in the United States have remained substantially constant whereas in the industrialized countries of Western Europe and Japan, wages have outstripped productivity gains.[3] For example, wages in Germany during 1961 increased by ten percent while productivity increased only five percent.[4] Thus it can be concluded that, although the United States has actually lost some competitive advantage in manufactured goods to other countries, the loss occurred during a period of postwar readjustment as foreign nations reentered the export market. This period is now past and, if the United States is successful in holding wages in line with productivity, this country should maintain its current share of the export market.[5]

In the immediate postwar years, most foreign currency was overvalued in relation to United States dollars. Since the cost of American

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[1]Salant, _op_. _cit_., p. 67.

[2]_Ibid_., p. 68.

[3]Salant, _op_. _cit_., p. 177

[4]The Chase Manhattan Bank, _Report on Western Europe Number 18_, June-July, 1962 (New York: The Chase Manhattan Bank).

[5]_Ibid_

exports in foreign money is equal to the price of the goods in dollars multiplied by the price of each dollar in terms of foreign money,[1] this overvaluation of foreign currencies made United States goods less expensive relative to foreign goods, thus further encouraging the importation of American products. This overvaluation also aggravated the inflation which existed in Europe at this time. However, in late 1949 most European nations devalued their currencies; this resulted in the inflationary trends in Europe being of comparable degree to that in the United States. This "cheapening" of their money by foreign nations on the exchange market also had the effect of promoting their exports and discouraging imports.[2,3]

Another cause of the balance of payments disequilibrium is the inflexibility of price to demand in the United States; the trend of prices is upward even during recession when demand is lessened. This condition in the United States is due to the wage rate's reluctance to drop and of oligopolistic firms refusal to lower prices, this having a deteriorating effect on the competitive position of this country. The greater economic and technological growth of foreign countries in relation to the United States in recent years has also operated to the disadvantage of the United States.

Finally, American business firms' desire to invest abroad and import the products has caused pressure on the United States' payments situation. This desire on the part of businessmen is due to foreign capital investment opportunities appearing better than those in the United States because of lower expenses overseas, better markets, and encouragement from foreign governments in the form of tax advantages. The significance of this outflow of dollars is slight, however; for example, in 1959 United States firms spent $433 million in Europe on capital investments or less than three percent of their total capital

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[1] William J. Baumol and Lester V. Chandler, Economic Processes and Policies, (New York: Harper and Brothers, 1954), p. 516

[2] Ibid., p. 517.

[3] Kindleberger, op. cit., p. 489.

investment. Of this three percent, only one fifth actually came from the United States; the balance came from overseas income, depreciation and other funds raised abroad by these firms.[1]

Another type of foreign investment tending to draw United States dollars out of the country are portfolio investments in foreign companies or institutions. Foreign nations, in their efforts to curb inflation, have raised allowable interest rates; this has the effect of enticing dollars out of this country to take advantage of these increased earning opportunities. United States Treasury officials and the Federal Reserve System have attempted similar strategies to keep American dollars at home as well as to keep inflation in check. They realize, however, that a very delicate balance must be maintained on the interest rate: a low rate encourages the domestic economy to expand since loans for capital improvements can be had for low interest rates, but those institutions possessing "loanable" funds look for borrowers who will pay the highest rate of interest. This may be overseas. On the other hand, if United States officials raise interest rates to head off an inflationary trend by making money less plentiful, the result will keep American dollars at home but may also overcorrect the inflationary trend and cause an economic recession.

It must also be remembered that foreign investments generate returns which may offset the amount of the original investment. During the period 1951-1961, earnings from foreign investments exceeded the outflow of new funds by $9 billion and, next to exports, were the largest single source of income in the balance of payments.[2] However, the indeterminable factor about these investments, whether they be for capital improvements or portfolio investments, is that they are in

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[1]The Chase Manhattan Bank, Report on Western Europe Number 10, October-November, 1960 (New York: The Chase Manhattan Bank).

[2]First National City Bank, Monthly Economic Newsletter, March, 1963 (New York: First National City Bank) p. 34.

some measure financing foreign facilities which produce goods or services which compete with United States products. Thus, although the earnings from these investments may be substantial, this surplus may be offset by a decrease in the export surplus of the current account cause by the competition generated by these investments.[1]

The causes for the balance of payments difficulties discussed thus far are those classified under the structural and monetary headings. However, in the case of the United States, this does not present a clear picture as to why the country continues to generate significant balance of payments deficit each year in spite of continued favorable balances of trade.

The political instability of the world today has resulted in the United States being committed to a policy which, although politically sound in the minds of most people, has some fiscal repercussions which warrant analysis.

The excess of exports over imports which the United States has enjoyed since World War II (and before) should, under normal circumstances, be adequate to provide a positive balance of payments even with foreign investment opportunities being what they are. However, the split between East and West is reflected by two significant expenditures by this country. One is the foreign economic and military aid program and the other is the substantial size of the American Armed Forces stationed in foreign countries.

The need for and amount of foreign aid expenditures made by the United States during the last several years is beyond the scope of this discussion; however, the impact of this aid in the balance of payments is significant as is shown from Figure 4.

Military forces of the United States and their dependents stationed in foreign countries and the 240,000 foreign nationals employed by the American forces are another cause for an abnormal outflow of dollars. Since 1961, this figure has averaged $2.4 billion annually

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[1] Salant, op. cit., p. 142.

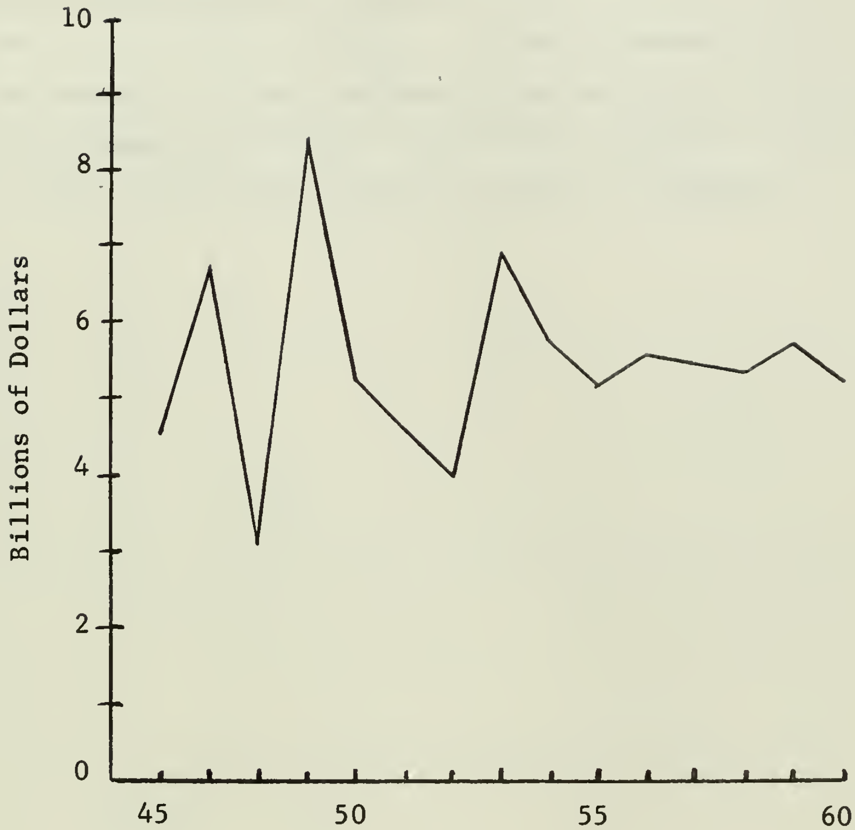

FIGURE 4

UNITED STATES ASSISTANCE
TO MUTUAL SECURITY
PROGRAM COUNTRIES
(1945-1960)

and will in all probability remain at about this figure indefinitely.[1]

Perusal of Figure 5 reveals that there is some correlation between the gold outflow and the deficit budgets which have existed in the United States since World War II. Deficit financing has two effects which are significant in gold flow considerations. First, deficit spending is inflationary; additional money must be "created" or borrowed to cover the deficiency. Secondly, budget deficits result in an undermining of the soundness of the nation's currency with the resulting tendency on the part of foreign creditors to take gold in lieu of short term loans to cover the cost of financing.

[1] Ibid. p. 193.

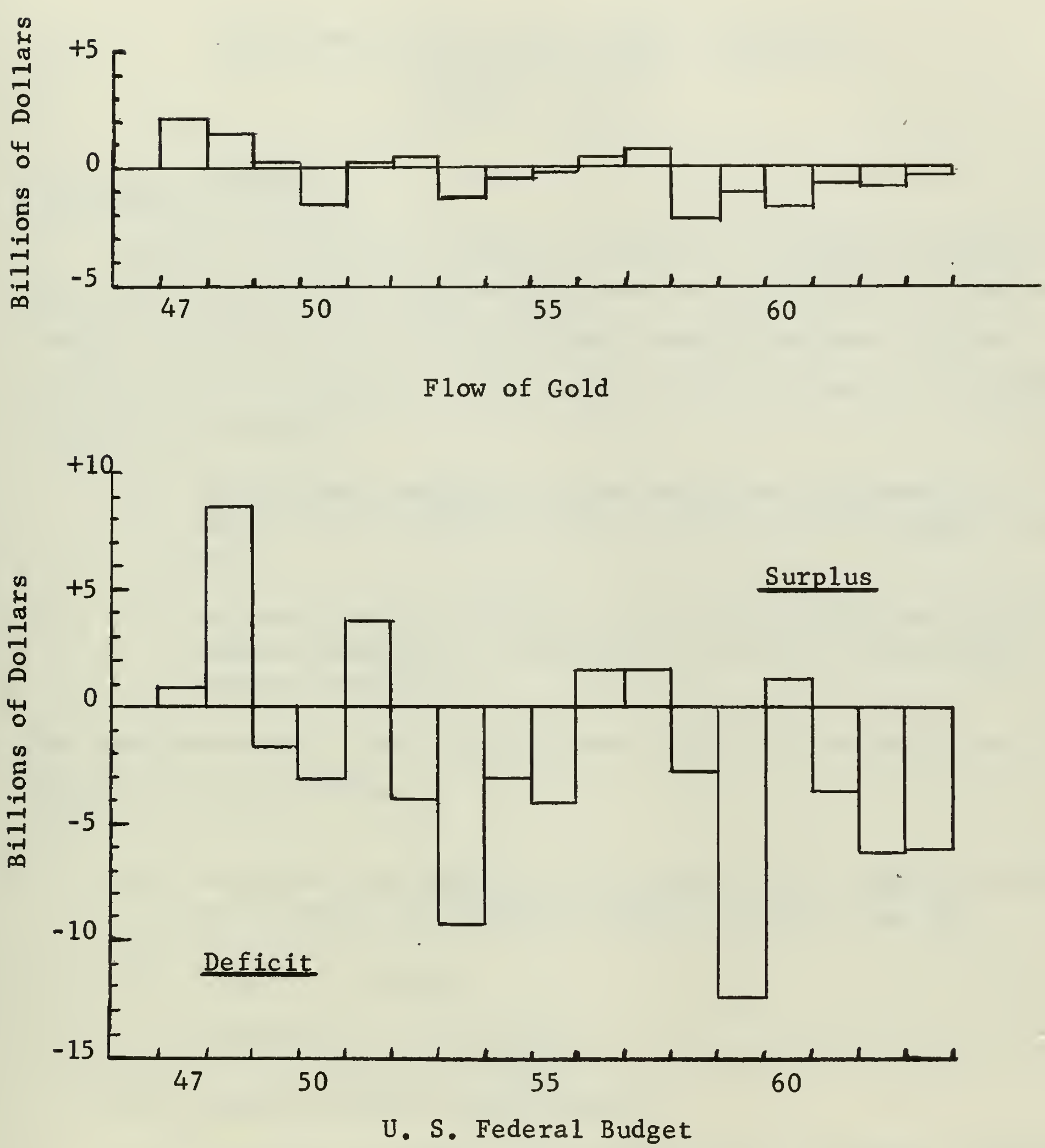

FIGURE 5

UNITED STATES FEDERAL BUDGET
AND FLOW OF GOLD

(1947-1963)

CHAPTER IV

SOLUTIONS TO THE UNITED STATES' BALANCE OF PAYMENTS DEFICITS

Alternate Solutions

Having discussed the causes of balance of payments problems in the United States, the methods available to this country to restore long range equilibrium to its international payments balance will be classified and evaluated. The alternate solutions may be classified into two categories:

1- Conventional methods or those which are necessary to maintain the integrity of the existing gold exchange standard, and

2- Unconventional solutions or those which would result in radical departures from present and past international monetary systems.

The alternates which are available under the first category mentioned above are the following:

a) Do nothing and assume that automatic self righting forces will correct the deficit condition in the long run.

b) Internal deflation.

c) Devaluation of the dollar.

d) Foreign currency appreciation.

e) Decrease in economic and military aid to foreign countries.

f) Decreasing the number of American Military Forces stationed overseas.

g) Increasing this country's favorable balance of trade.

h) Altering rediscount rates by the Central Bank to discourage foreign investments by U. S. interests.

i) Direct government control over foreign investments through taxation or other means.

The unconventional solutions are:

a) Establish an international currency.

b) Abandonment of the gold standard.

These alternates are evaluated below.

The United States' monetary system is based on a modified gold bullion standard with the dollar being "pegged" to a fixed amount of gold.[1] This fixed amount of gold content in each dollar is presently defined as 15 and 5/21 grains of 9/10 fine gold which, in turn, establishes the price of gold at $35 per fine ounce.[2] Under this system, adequate reserves of gold must be maintained to insure the fulfillment of legal requirements pertaining to the amount of money in circulation. Currently, this requirement is set at 25%, that is not less than 25% of the federal reserve notes and deposit liabilities in circulation must be backed by gold owned by the U. S. Treasury.

A continued deficit in balance of payments with its resulting loss of gold will eventually result in the United States possessing inadequate reserves to provide the international liquidity required to conduct world trade and financial transactions.[3] Thus, the first category of solutions to this country's balance of payments difficulties are designed to eliminate the persistent gold loss by means of balancing the country's international payments.

The first and simplest course of action to follow is to do nothing and assume that the current deficit balance is temporary or cyclic in nature. In normal times, the balance of payments cannot be expected to be in equilibrium each year; however, in the long run, the surpluses should balance the deficits.

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[1] Thomas, op. cit., p. 40.

[2] Ibid. p. 62.

[3] The crucial element in liquidity is the possession of assets readily convertible, without loss, into instruments of payment. Gold is the most internationally liquid of all assets.

In the case of the United States since 1958, certain forces have, in fact, been acting to reduce the deficit. Europe and Japan have accumulated substantial quantities of gold and foreign exchange reserves; therefore, the marginal value of additional monetary reserves has decreased, thus encouraging greater imports of goods and services by these nations.[1] Also, Japan and Europe during this period were experiencing increasing rates of costs in comparison with the United States thereby making this country more competitive in the export markets.[2] However, although these and other influences do exist to favor the United States position, they are not sufficient to fully offset the forces causing the payments deficit. This leads to the conclusion that positive action must be taken by the United States in order to solve its payments balance problem.

Internal deflation, accompanied by a general lowering of prices is another method of correcting the deficit in the United States' balance of payments. However, deflation in modern economies inevitably causes a decrease in aggregate production and employment. Thus, this solution can only be reasonably used when a nation's balance of payments problems are caused by internal inflation,which is not the condition which exists in the United States. Further, an attempt to lower the general level of prices when current production and employment are already below prosperity levels would not only prevent economic recovery but would threaten to worsen an already weak economy.[3] It should be noted that the United States experienced its most severe balance of payments deficits during 1958-1960 when the economy was recovering from a period of recession.

However, selective price reductions of certain items through either voluntary means or by government encouragement by tax concessions

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[1]Snider, op. cit., p. 323.

[2]See Chapter III.

[3]Snider, op. cit., p. 324.

would, on the other hand, be a step toward righting a deficit balance of payments by making these products more competitive on foreign markets. However, this, too, would probably be of little significance due to the small dollar value involved and the difficulty of successfully pursuing such a program without direct government control.

A very effective but highly controversial alternative remedy to a deficit payments balance would be devaluation of the dollar. Overvaluation of foreign currencies in relation to the dollar in the immediate postwar period was generally agreed to be one of the reasons for the United States surplus in balance of payments during this period. While devaluation would reduce balance of payments deficit by making United States' products cheaper in relation to foreign products, its major disadvantage would be in undermining the status and prestige of the dollar on the international market. Foreign institutions and individuals would be less inclined to retain their holdings in short term capital but would tend to convert their holdings to gold, thereby defeating the purpose of the devaluation. Equally important is the fact that the United States is the world's leading banker and is responsible for a large part of the monetary reserves of foreign countries and for the great bulk of international working balances of foreign bankers, traders, and investors.[1] Devaluation would curtail the dollar's position as an international currency. Finally, certain fiscal experts feel that devaluation would only be a temporary solution and that the more basic reasons for the balance of payments problem would ultimately cause further deficits.[2]

A remedy to balance of payments deficits which could be considered as complimentary to dollar devaluation would be foreign currency appreciation. Although only one overt example of this phenomenon has occurred since World War II and that in Germany in March, 1961,

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[1]Statement of William McC. Martin, Jr., December 28, 1962 op. cit.

[2]Snider, op. cit., p. 326.

the general weakening of the dollar during the past ten years has had the effect of appreciating all foreign currencies.

A further possible remedy to the United States payments difficulties would be a decrease in the amounts which the country spends in military and economic aid to foreign countries. As noted in Chapter III and shown in Figure 4 and in Appendix B, the amount of this aid has exceeded $5 billion annually in recent years. Most of the money is "tied" money, that is, must be spent on United States' products and thus returns to this country in payment for some of our current account exports.[1] A reduction in the amount of foreign aid would result in a corresponding reduction in United States' products sold to the countries receiving aid. However, it is not likely that the decrease in funds received from this country would result in the receipients decreasing their expenditures for American goods by a like amount;[2] thus, it can be concluded that the overall payments deficit would be improved by decreases in foreign aid but not on a dollar for dollar ratio.

Since the advent of the "cold war", this country has maintained fully equipped military forces in many foreign countries, notably Western Europe. These forces in Europe alone are made up of some 340,000 soldiers and airmen under the U. S. European Command, plus some 270,000 dependents and 154,000 foreign nationals hired locally to support the American forces.[3] These forces are responsible for an outflow of approximately $2.4 billion annually into the countries wherein they are stationed. While the services of these forces will be required during the foreseeable future, there is an alternate method of maintaining the availability of United States military striking forces which would also result in a significant reduction in the $2.4 billion which leaves this country each year through our forces

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[1] Salant, *op. cit.*, p. 157.

[2] Snider, *op. cit.*, p. 329.

[3] *Wall Street Journal*, November 21, 1963, p. 1. These figures do not include forces stationed in locations other than Europe.

overseas. This alternate method consists of maintaining the major portion of American forces on board Naval aircraft carriers, and amphibious craft of all type. Thus, instead of the large number of ground forces located in overseas locations, equivelent forces, consisting of attack aircraft and amphibious troop units of sufficient size and equipped with weapons to cope with any contingency, could be strategically located so as to be available for service at short notice. These forces, which would be an extension of the forces currently on station with the United States Sixth Fleet in the Mediterranean Sea, would be kept in a state of constant readiness through frequent training exercises of the type currently perfected for use.

Perhaps 200,000 land based Army troops could be replaced in this manner. The removal of this many personnel plus their dependents and supporting personnel would substantially reduce the amount of American dollars flowing into other economies.

Quite obviously, one of the most powerful methods of ending the balance of payments deficit would be to significantly increase the value of United States exports over imports, thereby increasing the current account surplus. However, this export surplus can only be effectively attained through the free functioning of international trade and not through governmentally imposed trade restrictions. American products must be competitive and must be wanted by foreign interests. Following World War II, most nations maintained strict control over the convertibility of their currencies into United States dollars, thus inhibiting the importation of American goods. These restrictions were gradually relaxed until by 1958 only a few remained. However, such restrictions as the "horsepower" tax which falls most heavily on American type automobiles, restrictive laws governing imported pharmaceuticals and certain tariffs still stand as barriers to increasing trade with foreign nations.[1] One of the stated purposes

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[1]The Chase Manhattan Bank, Report on Western Europe Number 18, June-July, 1962 (New York: The Chase Manhattan Bank).

of the International Monetary Fund is the implementation of complete convertibility of all currencies, thus permitting full and free trade between nations, provided no artifically imposed internal controls are instituted by any few governments.[1]

The full impact of any trade implications brought about by the advent of the Common Market is yet to be felt. If the Common Market is successful in increasing the wealth of its member nations, the United States could benefit by increased purchases of American products by these nations; on the other hand, if these nations choose to raise tariff barriers with "outsiders", the United States may find itself in a poorer position than at present. The Brookings Institution, in its projections for balance of payments status through 1968, concludes that the Common Market will ultimately have an adverse effect on the United States trade balance if its present policies are continued, even though American exports to the member countries should increase substantially.[2]

A monetary policy which would tend to decrease balance of payments deficits would be for the Federal Reserve Board to raise its rediscount rate high enough to discourage investments abroad by United States investors while at the same time attracting foreign money into this country. However, the rediscount rate is usually set to work in conjunction with the United States economy; it is an unlikely tool to be used to control the balance of payments. Also, it is likely that foreign nations' central banks would react by raising their own rediscount rates.

Finally, through direct control, the government can limit the amount of U. S. capital flowing into foreign security investments.

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[1]American Management Association, <u>Sources and Methods of International Financing</u>, AMA Management Report No. 59, (New York: American Management Association, 1961), p. 10.

[2]Salant, <u>op. cit.</u>, pp. 95-115.

However, as discussed in Chapter III, these foreign investments generate returns which, in the long run, more than off set their initial outflow of dollars. Thus, in a sense, such actions would "kill the goose that laid the golden egg".[1] In addition, with the dollars they receive from United States purchases of their securities, foreign countries are better able to buy American goods and services.[2] To limit these investments would not only cut off this source of income to the United States but would cast a shadow over the United States' long standing policy of freedom for capital movements. Such a policy might well have the effect of further undermining the confidence of foreigners in this country.[3]

The ten courses of action discussed above are directed primarily toward eliminating the balance of payments deficits and preserving this country's gold reserves and thus to insure adequate liquidity under the existing old exchange standard. However, some economists have proposed more radical methods of solution which would result in a basic reform in the international monetary system. One of the most notable of these departures is the so called Triffin Plan.[4] Under this plan an international money would be created to replace or substitute for the present use of national currencies as international reserves. This would eliminate one of the major sources of weakness in the gold exchange standard. The national currencies would be replaced in their role as international reserves by deposit accounts held by member countries with an expanded International Monetary

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[1] Wall Street Journal, February 13, 1964.

[2] Ibid.

[3] Ibid.

[4] Named after Professor Robert Triffin of Yale University and described in his book Gold and the Dollar Crisis (New Haven: The Yale University Press, 1960)

Fund.[1] This plan would have the effect of creating an international central bank. Properly managed, it would remove the limitations presently imposed by a monetary system dependent on the available stocks of gold where the replenishments of some countries reserves to a satisfactory level can only be achieved at the expense of reducing other countries' reserves to an inadequate level.[2]

Another radical departure from current international monetary policy would be abandonment of the gold standard and allowing the value of each nations currency on the international market to be determined by the principles of supply and demand. The full implications of such a move are beyond the scope of this paper, but like the Triffin plan, the international liquidity of each nation would not be tied to its supply of gold.

Corrective Action by the United States since 1958

Having discussed the various methods available to the United States to combat its balance of payments deficit, an examination of courses of action which have actually been attempted during the last six years by this country will be made.

Following the fiscal year 1959 deficit budget, great efforts were taken to balance the federal budget and, although deficits continued, they were considerably reduced from 1959. (See Figure 5). In 1960 dependents of military personnel were temporarily precluded from going overseas to foreign countries in order to reduce the spending of United States dollars outside of the country. However, this action

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[1]The International Monetary Fund was established by the United Nations Monetary and Financial Conference held in Bretton Woods in July 1944. The objective of the I. M. F. is to reconcile the expansion and balanced growth of international trade, free from the disruptions of unstable rates of exchange, with the maintenance of high levels of employment and real income in each country.

[2]Snider, op. cit., p. 520.

was suspended because of its insignificant effect on the payments balance, and, its adverse effect on the morale of military forces overseas. Aid grants were further analysed each budget year in an effort to reduce these unilateral transfers; however, they seem to be fairly well stabilized at approximately $5.0 billion per year. By 1960 our trade surplus had improved and the gold outflow was due in large part to short term capital outflows stimulated by differentials in interest rates which were low in the United States and high in Japan and Europe.[1] Since 1958, the Federal Reserve System had increased its member bank reserves by some $6.5 billion thereby increasing the available supply of money in the United States by a substantially greater amount. There is difference of opinion as to whether the balance of payments deficit required the "Fed" to increase reserves to offset the gold loss or whether the increased reserves aggravated the payments deficit.[2] In any event, the low domestic interest rates caused much of this "new money" to leave the country in search of more lucrative markets. This availability of "cheap" money in the United States prompted foreigners to increase their borrowings of new issues here from $300. million per year prior to 1954 to over $1.0 billion in 1962.[3] In an effort to encourage foreign investors to keep their holdings in dollars rather than converting to gold, the United States is currently selling bonds to foreign countries payable in their own currency, thus protecting the investor against a dollar devaluation.[4] In early 1964 the United States Treasury borrowed $125. million in foreign currencies from the International Monetary Fund for the purpose of slowing the flow of

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[1]American Management Association, op. cit., p. 25

[2]"The Balance of Payments Bind," Fortune, LXVII-6 (June, 1963) p. 112.

[3]Ibid.

[4]"Push to Sell Bonds in Foreign Currency", Business Week, March 30, 1963, p. 88.

gold. The United States will use these foreign currencies to buy dollars that have accumulated in the hands of foreign central banks; otherwise these foreign holders might use these dollars to buy gold from the United States.[1] These are quite obviously stopgap measures employed to slow the flow of gold until more permanent solutions are found.

There is before Congress at present a bill which would place a tax on American investors who bought shares of foreign equity securities. This is a controversial bill because, as explained earlier, the return on these investments exceeds, in the long run the amount invested.

The Balance of Payments Situation in 1964

The amount of gold presently possessed by the United States is about $15.5 billion whereas United States liabilities to foreign countries and international financial bodies is considerably in excess of this amount, thus inferring the constant threat of a run and of quick exhaustion of this nation's gold supply. However, a look at the creditors reveals that approximately 70 per cent of the claims are held by international institutions and the world's central banks neither of which would be likely to make a run on United States gold stocks. Some $8.0 billion consists of private claims; however, United States private investors hold some $7.0 billion in short term claims on foreigners. Thus the possibility of any immediate exhaustion of American gold by foreign investors is remote. This conclusion is also borne out by the fact that United States long term investments abroad exceed the long term investments by foreign interests in this country by $30.0 billion, that is, the United States possesses a substantial surplus of assets over liabilities on its international balance sheet.[2]

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[1] Wall Street Journal, February 14, 1964, p. 1.

[2] First National City Bank, Monthly Economic Newsletter, January, 1963 (New York: First National City Bank), p. 8.

President Johnson, in his economic message of January 1964, noted that, although the balance of payments deficit is still present, it has significantly been reduced. This improvement can be attributed basically to three factors:[1,2] First, foreign bond issues in the United States market practically ceased in late 1963 after having reached $1.0 billion during the first half of the year. This decrease was due to the possibility of retroactive passage of the interest equalization tax. Second, a rise in short term interest rates in the United States resulted in a sharp decrease in short term investments abroad. Finally, an increase of five percent over 1962 in the United States' export trade surplus and increased returns from American investments abroad improved the balance of payments picture.

On the other hand, this improvement may be shortlived and the gold flow could rise to as much as $600. million in 1964. Reasons advanced for this theory are the fact that foreign central banks during 1963 accumulated large additional dollar holdings in lieu of taking gold and may want to add fewer dollars in 1964. In addition, foreign governments used $1.0 billion in dollars for debt prepayment and military advances to the United States and purchase of United States bonds.[3] Such payments are expected to be considerably less in 1964. Also, actual passage of the interest equalization tax will have the effect of starting up purchases of foreign securities again.[4]

Finally, despite the severe gold losses by the United States and the prospect of continued losses in the years ahead, United States

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[1] The New York Times, January 6, 1964

[2] Business Week, January 25, 1964, p. 98.

[3] Business Week, January 11, 1964, p. 34.

[4] The New York Times, January 6, 1964.

reserves and other resources for meeting continued deficits in the payments balance remain very great. They include:[1]

1- Monetary gold holding of over $15 billion. All of these holding can be made available for international settlements, since the requirement of a 25 percent gold reserve against Federal Reserve notes and deposit liabilities can be suspended.

2- Treasury and Federal Reserve holdings of convertible foreign currencies and stand-by facilities, now amounting to about $1.5 billion.

3- Drawing rights in the International Monetary Fund amounting to over $5 billion of which over $1 billion is almost automatically available on demand and the remainder at the IMF's discretion.

4- The United States government's ability to obtain foreign currency through further prepayments by European governments of long term debts and, if necessary, by the sale abroad of United States securities in exchange for foreign currencies.

Adverse Effects of a Balance of Payments Surplus in the United States

Thus far this discussion has centered around the deficit in the United States balance of payments and the seriousness of continued gold losses to the United States. However, there is some apprehension that if the United States program to stop its gold outflow is successful and surplus balances of payments are realized, trade in other parts of the world might be impared. These fears seem to be concentrated mainly in the Common Market countries.[2]

The key to a nation's ability to carry out trade is its international liquidity, that is, gold, foreign exchange and other international credit which a nation has available to meet its obligations. In recent years, Common Market countries have built up their

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[1] Salant, op. cit., p. 252.

[2] The Wall Street Journal, December 26, 1963.

liquidity mainly at the expense of the United States. If this source of liquidity is cut off, which would be the case should the United States develop a payments surplus, Common Market countries might be forced into restrictive monetary policies to conserve their gold supplies. This would adversely affect world trade.[1]

Thus, some economists are wondering about the adequacy of the entire world's monetary system. This inadequacy may be said to stem from two circumstances. First, the major advanced countries are more likely to be faced with payments imbalances caused by structural factors such as changes in technology, competitive position, or relative productivity rather than by imbalances caused by excesses of aggragate demand. When imbalances result from structural factors, the nations affected cannot eliminate these imbalances without jeopardizing the stability of their domestic economies. Secondly, the existing world monetary mechanism does not provide enough liquidity to enable countries to finance deficits over periods long enough to reach equilibrium by using the much slower means that do not jeopardize vital objectives.

If the United States' deficit is eliminated and the growth of reserves becomes dependent solely on the increases of monetary gold stocks, the inadequacy of international liquidity will become increasingly acute.[2]

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[1] Salant, op. cit., p. 242.

[2] Ibid., p. 243.

CHAPTER V

CONCLUSIONS AND RECOMMENDATIONS

As the discussions of the previous chapters have indicated, there are several courses of action which the United States could follow in effectively eliminating its balance of payments deficit. However, certain of these alternates have significant disadvantages which result in them being unsuitable for accomplishment in the world as it exists today. These alternates are cited below, and will not be considered further.

Devaluation of the dollar and regulation of the rediscount rate solely to control the payments balance would create more problems then they would solve. Also, experience has indicated that the government cannot observe a laissez-faire policy and hope that, in the long run, the international payment deficit will be balanced out by payment surpluses. Finally, direct government control over international payments by taxation or regulation over the free convertibility of U. S. currency into foreign currency is to be avoided if at all possible. Direct government control has a stigma attached to it which places a doubt on the stability of the monetary system's ability to sustain itself. The results of such doubts are unpredictable, but often have resounding significance.

This leaves five alternatives worthy of further consideration:

1- Increase the favorable balance of trade.

2- Decrease foreign economic and military aid.

3- Decrease United States military forces deployed in foreign countries.

4- Establish an international currency.

5- Abandon the gold standard.

Table III shows that the payments deficit over the past few years has approximated \$2 billion per year. Figure 3 shows that the exports of goods and services from this country has amounted to almost \$30 billion

annually with the net excess over import approximately $5. billion annually. Thus, a 7% increase in exports (with no increase in imports) would make up the $2 billion deficit. The United States is in a good position to increase the volume of its exports because of the severe inflationary trends currently existing in Europe and Japan. However, a word of caution is in order. The specter of inflation still exists in the United States and unless costs are kept in balance with productivity, this country will quickly lose the competitive advantage it has recently gained from foreign industrialized countries. It must also be remembered that a sifnificant increase in exports will undoubtedly result in some increases in imports. More raw materials will be needed, and some of the dollars resulting from increased exports will ultimately find their way back out of the country through various means. What should be the goal here is that the net increase in exports should approach 7% or more.

In considering the approximately $5. billion in economic and military assistance which this nation spends annually, it is quite obvious that all of this amount cannot be eliminated. However, by carefully defining the uses to which this money can be put and re-assessing the areas where this assistance is needed, efforts should be made toward a programmed reduction in the amount appropriated for this purpose each year. Not only should efforts be made to put the available funds to better use, but foreign nations should be forced to carry their share of such aid where it is needed.

Before any decision could be made regarding the substitution of a highly mobile naval force for a portion of the ground forces now stationed in foreign countries, feasibility studies would be needed to determine actual equipment and manpower requirements. If it were determined that such a force could in fact furnish the necessary striking power when and where needed, a comprehensive effort would then be required to overcome the political repercussions which would certainly follow any attempts by the United States to remove its troops from foreign soil, especially Western Europe.

However, the type of force advocated here could have significant operational advantages, far and above balance of payments considerations. These potential advantages should be investigated.

Probably the most thought provoking of the possible plans for solving this country's balance of payments program is the one involving the establishment of what would amount to an international Federal Reserve Bank. Implementation of the "Triffin Plan" or one similar to it would remove the limitations now inhibiting full development of international trade and exchange because of its dependency on the gold exchange standard. A plan such as this shows great promise as a permanent solution to the inadequate international liquidity which is developing in the world today.

The fifth alternative of complete abandonment of the gold standard would not entail as significant a change as would initially be implied. The legal requirement for 25% gold backing of our currency could easily be removed, freeing that additional gold for international transactions. Table V reveals that only a small portion of our money supply is in the form of currency or coin; most of it is in the form of demand deposits. However, the full effects of complete abandonment of the gold standard would not be fully predictable and unless a positive advantage could be expected, such a move should not be attempted. The establishment of a well managed international monetary system would accomplish the same ends as abandonment of the gold standard with a lesser amount of risk. It is concluded therefore that abandonment of the gold standard should not be attempted solely to solve the international payments system.

To sum up, in order to solve its balance of payments problem the United States should:

1- Increase the value of its exports while keeping its imports minimized.

2- Maintain its costs of productivity in line with its rate of productivity.

Currency and Demand Deposits

(In Billions of Dollars)

As of January, 1964

1- Small Change		
Minor Coins	$ .7	
Silver Coins	2.4	
		$ 3.1
2- Paper Currency		
Federal Reserve Notes	$33.6	
Silver Certificates and U. S. Notes	2.3	
Other Currency	0.2	
		$ 36.1
3- Bank Money		
Demand Deposits of all Banks		$122.3
Total Money		$161.5

Source: Federal Reserve Bulletin, April 1964

TABLE V

3- Investigate the possibility of replacing a significant portion of United States military forces stationed in foreign countries with a mobile afloat force consisting of aircraft and amphibious units.

4- Establish a planned reduction of its foreign assistance funds.

5- Establish, in conjunction with other nations of the free world, an international monetary system.

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APPENDIX A

Federal Budget Statistics

(Administrative Budget)
Billions of Dollars

Fiscal Year	Receipts	Expenditure	Surplus (+) Deficit (-)
1946	39.7	60.3	-20.7
1947	39.7	38.9	+ .8
1948	41.4	32.9	+ 8.4
1949	37.7	39.5	- 1.8
1950	36.4	39.5	- 3.1
1951	47.5	44.0	+ 3.5
1952	61.3	65.3	- 4.0
1953	64.7	74.1	- 9.4
1954	64.4	67.5	- 3.1
1955	60.2	64.4	- 4.1
1956	67.9	66.2	+ 1.6
1957	70.6	68.9	+ 1.6
1958	68.6	71.4	- 2.8
1959	67.9	80.3	-12.4
1960	77.8	76.5	+ 1.2
1961	77.6	81.5	- 3.8
1962	81.4	87.8	- 6.3
1963	86.3	92.6	- 6.2

Source: Federal Budget - FY 1965

APPENDIX B

Foreign Assistance Expenditures - Balance of Payments Deficit
(Millions of Dollars)

Fiscal Year	Econ.	Mil.	Total
1946 1947 1948	13951.2	481.2	14432.4
1949	8113.8	301.3	8415.1
1950	5104.8	76.0	5180.8
1951	3662.3	980.4	4642.7
1952	2469.8	1481.2	3951.0
1953	2603.7	4272.0	6875.7
1954	2428.5	3379.7	5808.2
1955	2727.4	2479.0	5206.4
1956	2680.5	2963.8	5644.3
1957	3325.7	2127.7	5453.4
1958	2982.7	2398.0	5380.7
1959	3667.9	2153.7	5821.6
1960	3436.9	1839.8	5286.7

Source: 1949-1960 - U. S. International Cooperation Organizations <u>U. S. Foreign Assistance and Assistance from International Organizations</u>

APPENDIX C

Balance of Trade in the United States

	Exports of Goods and Services	Import of Goods and Services	Difference
1947	19,739	8,208	11,529
1948	16,789	10,349	6,440
1949	15,770	9,621	6,149
1950	13,807	12,028	1,779
1951	18,744	15,073	3,671
1952	17,992	15,766	2,226
1953	16,947	16,561	386
1954	17,759	15,931	1,828
1955	19,804	17,795	2,009
1956	23,595	19,628	3,967
1957	26,481	20,752	5,729
1958	23,067	20,861	2,206
1959	23,476	23,342	134
1960	26,974	23,206	3,769
1961	28,311	22,867	5,444
1962	29,790	24,964	4,826

Source: U. S. Department of Commerce, Survey of Current Business